



Bill Draft 2013-RBxz-47: Deduction for State Net Loss.

2013-2014 General Assembly

Committee: Revenue Laws Subcommittee
Introduced by:
Analysis of: 2013-RBxz-47

Date: April 4, 2014
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SUMMARY: *The bill draft 2013-RBxz-47 would replace the corporate net economic loss deduction with a State net loss deduction for taxable years beginning on or after January 1, 2015.*

CURRENT LAW: Both federal and State tax law provide relief to a corporation that incurs more expenses than revenues during the taxable period. For federal tax purposes, a corporation is allowed a net operating loss deduction equal to the amount by which tax deductible expenses are more than taxable revenues. The federal deduction may be carried back two years preceding the loss year, thus providing immediate tax relief in the form of a tax credit; any unused portion of the deduction may be carried forward for 20 years. For State tax purposes, a corporation is allowed a net economic loss deduction¹ equal to the amount by which allowable deductions for the year other than prior year losses exceed income from all sources in the year, including nontaxable income.² The State deduction may be carried forward 15 years; any loss carryforward must first be offset by nontaxable income, including allowable deductions.

BILL ANALYSIS: This draft does three things to simplify the calculation and ease the administration of the corporate loss deduction, effective for taxable years beginning on or after January 1, 2015:

- It replaces the net economic loss calculation with a State net loss calculation that is more comparable to the federal net operating loss calculation.
- It removes the requirement that a net economic loss carried forward to taxable years beginning on or after January 1, 2015, be first offset by nontaxable income.
- It instructs the Secretary of Revenue to apply the standards under sections 381 and 382 of the Code when determining to what extent a loss survives a merger or an acquisition.

The draft would replace the State's net economic loss deduction with a State net loss deduction. The State net loss would be the amount by which allowable deductions for the year, other than prior year losses, exceed gross income under the Code for the year adjusted as provided in G.S. 105-130.5. Adjustments under G.S. 105-130.5 include items such as the adjustments taxpayers must make when the State decouples from federal accelerated depreciation and expensing. If the taxpayer is a multi-state

¹ NC is the only state with a net economic loss deduction that differs significantly from the federal net operating loss deduction. Other states that have a corporate income tax loss deduction use a calculation that is comparable to the federal net operating loss deduction.

² Nontaxable income includes income that has been deducted in computing State net income, nonapportionable income that has been allocated directly to another state under G.S. 105-130.4, and any other income that is not taxable under State law. Prior to August 17, 2013, the Department of Revenue interpreted G.S. 105-130.8 to require items deductible under G.S. 105-130.5, such as U.S. government interest and dividends, to be considered in the computation of the loss in the year of creation as nontaxable income. The Department revised its interpretation to recognize that an allowable deduction, although not taxable, may not reduce a loss in the year the loss is created. However, pursuant to G.S. 105-130.8(a)(3), the Department continued to require that a loss carried forward to a subsequent year must first be offset by any income not taxable, including allowable deductions under G.S. 105-130.5.



Draft

Page 2

corporation with business within and without North Carolina, then the loss must be allocated and apportioned in the year of the loss in accordance with G.S. 105-130.4.

The repeal of the net economic loss deduction removes the applicability of North Carolina case law that governs the extent to which a net economic loss survives in a merger or an acquisition. The draft instructs the Secretary of Revenue to apply the federal regulations adopted under sections 381 and 382 of the Code in determining the extent to which a loss survives in a merger or acquisition. Although the provisions of the Code would be applied, the loss limitations may differ at the State level based upon the single entity reporting requirement in North Carolina and subject to the allocation and apportionment provisions of G.S. 105-130.4 in the year of the loss.

The draft changes the calculation of a net economic loss carry-forward. Under current law, the carry-forward must be reduced by nontaxable income. What constitutes nontaxable income has been a source of questions, disagreements, and litigation. Under the draft, the amount of the net economic loss, as determined on December 31, 2014, becomes a static amount. Any unused portion of a net economic loss carried forward in taxable years beginning on or after January 1, 2015, would be administered in accordance with the State net loss statute:

- Any unused portion of a net economic loss would not have to first be offset by nontaxable income.
- The standards under sections 381 and 382 of the Code would be applied in determining the extent to which a net economic loss survives a merger or acquisition that occurs on or after January 1, 2015.

EFFECTIVE DATE: The draft becomes effective for taxable years beginning on or after January 1, 2015.